



**NATIONAL GALLERY OF ART**

Financial Statements

September 30, 2012

(With Independent Auditors' Reports Thereon)



**KPMG LLP**  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

## **Independent Auditors' Report**

To the Board of Trustees of  
The National Gallery of Art:

We have audited the accompanying statement of financial position of the National Gallery of Art (the Gallery) as of September 30, 2012, and the related statements of activities, and cash flows (hereinafter referred to as financial statements) for the year then ended. These financial statements are the responsibility of the Gallery's management. Our responsibility is to express an opinion on these financial statements based on our audit. The accompanying summarized comparative information has been derived from the Gallery's September 30, 2011 financial statements, which were audited by other auditors whose report thereon dated November 14, 2011, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Gallery's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Gallery as of September 30, 2012, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

November 15, 2012

## NATIONAL GALLERY OF ART

### Statement of Financial Position

September 30, 2012

(with summarized financial information as of September 30, 2011)

(In thousands)

<b>Assets</b>	<b>2012</b>			<b>2011</b>
	<b>Private</b>	<b>Federal</b>	<b>Total</b>	<b>Total</b>
Cash and cash equivalents	\$ 8,222	\$ 65,254	\$ 73,476	\$ 106,726
Accounts receivable and other assets, net	5,601	—	5,601	5,945
Pledges receivable, net	18,874	—	18,874	6,991
Investments and trusts held by others	700,579	—	700,579	620,997
Property, plant and equipment, net	55,173	211,372	266,545	224,578
Art collections	—	—	—	—
Total assets	\$ 788,449	\$ 276,626	\$ 1,065,075	\$ 965,237
 <b>Liabilities and Net Assets</b>				
Liabilities:				
Accounts payable and other liabilities	\$ 10,361	\$ 32,390	\$ 42,751	\$ 40,371
Capital lease obligation	—	1,110	1,110	1,330
Unexpended federal one-year appropriations	—	11,848	11,848	12,150
Contractual obligations	—	—	—	7,874
Environmental liability	—	21,025	21,025	19,989
Total liabilities	10,361	66,373	76,734	81,714
Net assets:				
Unrestricted:	250,382	175,656	426,038	336,245
Temporarily restricted	157,871	34,597	192,468	182,941
Permanently restricted	369,835	—	369,835	364,337
Total net assets	778,088	210,253	988,341	883,523
Total liabilities and net assets	\$ 788,449	\$ 276,626	\$ 1,065,075	\$ 965,237

See accompanying notes to financial statements.

**NATIONAL GALLERY OF ART**  
Statement of Activities  
Year ended September 30, 2012  
(with summarized financial information for the year ended September 30, 2011)  
(In thousands)

	<u>Unrestricted private</u>	<u>Unrestricted federal</u>	<u>Total</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2012</u>	<u>Total 2011</u>
Operating:							
Support and revenue:							
Federal appropriations	\$ —	\$ 103,371	\$ 103,371	\$ 7,175	\$ —	\$ 110,546	\$ 108,050
Gifts and grants	3,157	—	3,157	7,235	—	10,392	8,693
Gallery shops sales, net	8,384	—	8,384	—	—	8,384	7,599
Spending policy appropriated for operations	2,750	—	2,750	13,675	—	16,425	14,368
Royalties and other income	1,633	—	1,633	—	—	1,633	4,233
	<u>15,924</u>	<u>103,371</u>	<u>119,295</u>	<u>28,085</u>	<u>—</u>	<u>147,380</u>	<u>142,943</u>
Net assets released from restrictions to fund operating expenses	<u>18,807</u>	<u>7,139</u>	<u>25,946</u>	<u>(25,946)</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total support and revenue	<u>34,731</u>	<u>110,510</u>	<u>145,241</u>	<u>2,139</u>	<u>—</u>	<u>147,380</u>	<u>142,943</u>
Expenses:							
Collections	3,286	41,931	45,217	—	—	45,217	44,492
Special exhibitions	5,778	13,442	19,220	—	—	19,220	17,320
Education, Gallery shops, and public programs	15,237	23,160	38,397	—	—	38,397	37,990
Editorial and photography	2,123	4,235	6,358	—	—	6,358	6,307
General and administrative	5,462	26,190	31,652	—	—	31,652	30,975
Development	2,730	1,721	4,451	—	—	4,451	4,475
Total expenses	<u>34,616</u>	<u>110,679</u>	<u>145,295</u>	<u>—</u>	<u>—</u>	<u>145,295</u>	<u>141,559</u>
Change in net assets from operating activities	<u>115</u>	<u>(169)</u>	<u>(54)</u>	<u>2,139</u>	<u>—</u>	<u>2,085</u>	<u>1,384</u>
Non-operating:							
Federal appropriations	—	7,080	7,080	10,794	—	17,874	50,261
Non-operating gifts and grants	2,069	—	2,069	18,718	4,340	25,127	4,978
Spending policy appropriated for art acquisitions	712	—	712	3,034	—	3,746	2,694
Changes in value of trusts held by others	(302)	—	(302)	40	1,158	896	(1,059)
Investment return less amounts appropriated for operations and art acquisitions	49,112	—	49,112	27,805	—	76,917	(12,953)
Acquisitions of works of art	(8,467)	—	(8,467)	—	—	(8,467)	(7,873)
Depreciation expense	(3,290)	(8,180)	(11,470)	—	—	(11,470)	(11,152)
Environmental liability expense	—	(1,066)	(1,066)	—	—	(1,066)	(612)
Provision for bad debts	(4)	—	(4)	—	—	(4)	(25)
Unrealized loss on sale of other asset	(820)	—	(820)	—	—	(820)	—
Reclassification of net asset balances	(1,301)	—	(1,301)	1,301	—	—	—
Net assets released from restrictions to fund non-operating expenses	<u>8,340</u>	<u>45,964</u>	<u>54,304</u>	<u>(54,304)</u>	<u>—</u>	<u>—</u>	<u>—</u>
Increase in net assets from non-operating activities	<u>46,049</u>	<u>43,798</u>	<u>89,847</u>	<u>7,388</u>	<u>5,498</u>	<u>102,733</u>	<u>24,259</u>
Increase in net assets	46,164	43,629	89,793	9,527	5,498	104,818	25,643
Net assets at beginning of year	<u>204,218</u>	<u>132,027</u>	<u>336,245</u>	<u>182,941</u>	<u>364,337</u>	<u>883,523</u>	<u>857,880</u>
Net assets at end of year	<u>\$ 250,382</u>	<u>\$ 175,656</u>	<u>\$ 426,038</u>	<u>\$ 192,468</u>	<u>\$ 369,835</u>	<u>\$ 988,341</u>	<u>\$ 883,523</u>

See accompanying notes to financial statements.

**NATIONAL GALLERY OF ART**

Statement of Cash Flows

For the year ended September 30, 2012

(with summarized financial information as of September 30, 2011)

(in thousands)

	<u>Private</u>	<u>Federal</u>	<u>Total 2012</u>	<u>Total 2011</u>
Cash flows from operating activities:				
Increase in net assets	\$ 96,323	\$ 8,495	\$ 104,818	\$ 25,643
Adjustments to reconcile increase in net assets to net cash used in operating activities:				
Depreciation and amortization	3,290	8,180	11,470	11,152
Amortization of discount on pledges receivable	(214)	—	(214)	(250)
Amortization of discount on contractual obligations	76	—	76	399
Provision for bad debts	4	—	4	25
Contributions and net investment income for permanently restricted investments	(1,538)	—	(1,538)	(995)
Federal appropriations for capital projects	—	(17,874)	(17,874)	(50,139)
Gifts and grants for art acquisitions and capital projects	(8,920)	—	(8,920)	(7,434)
Acquisitions of works of art	8,280	—	8,280	7,459
Realized and unrealized gains on investments	(92,437)	—	(92,437)	(68)
Unrealized loss on sale of other asset	820	—	820	—
Change in value of trusts held by others	(2,005)	—	(2,005)	2,130
Change in accounts receivable and other assets, net	(480)	—	(480)	(551)
Change in pledges receivable, net	(11,669)	—	(11,669)	4,213
Change in accounts payable and other liabilities	(375)	(3,826)	(4,201)	4,638
Change in unexpended one-year federal appropriations	—	(302)	(302)	322
Change in environmental liability	—	1,036	1,036	377
Net cash used in operating activities	<u>(8,845)</u>	<u>(4,291)</u>	<u>(13,136)</u>	<u>(3,079)</u>
Cash flows from investing activities:				
Purchase of investments	(72,845)	—	(72,845)	(227,533)
Proceeds from sale of investments	87,705	—	87,705	247,627
Acquisitions of works of art	(8,280)	—	(8,280)	(7,459)
Purchase of property, plant and equipment	(633)	(46,223)	(46,856)	(35,123)
Net cash provided by (used in) investing activities	<u>5,947</u>	<u>(46,223)</u>	<u>(40,276)</u>	<u>(22,488)</u>
Cash flows from financing activities:				
Contributions and net investment income for permanently restricted investments	1,538	—	1,538	995
Federal appropriations for capital projects	—	17,874	17,874	50,139
Gifts and grants for art acquisitions and capital projects	8,920	—	8,920	7,434
Principal payment on capital lease obligation	—	(220)	(220)	(202)
Payments on contractual obligations	(7,950)	—	(7,950)	(8,325)
Net cash provided by financing activities	<u>2,508</u>	<u>17,654</u>	<u>20,162</u>	<u>50,041</u>
Net change in cash and cash equivalents	<u>(390)</u>	<u>(32,860)</u>	<u>(33,250)</u>	<u>24,474</u>
Cash and cash equivalents, at beginning of year	8,612	98,114	106,726	82,252
Cash and cash equivalents, at end of year	<u>\$ 8,222</u>	<u>\$ 65,254</u>	<u>\$ 73,476</u>	<u>\$ 106,726</u>
Supplemental disclosure of cash flow information:				
Cash paid during the year for:				
Interest on capital lease	\$ —	\$ 122	\$ 122	\$ 140
Income taxes	131	—	131	245
Supplemental disclosure of noncash information:				
Donated investment securities	\$ 1,099	\$ —	\$ 1,099	\$ 1,078
Capital additions included in accounts payable	187	10,138	10,325	3,567

See accompanying notes to financial statements.

# NATIONAL GALLERY OF ART

Notes to Financial Statements

September 30, 2012

(In thousands)

## (1) Organization

The National Gallery of Art (the Gallery) was created in 1937 for the people of the United States of America by a joint resolution of Congress, accepting the gift of financier and art collector Andrew W. Mellon. The Gallery is a nonprofit organization exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code.

The Gallery serves the United States in a national role by preserving, collecting, exhibiting, and encouraging the understanding by the American public of original, great works of art. This mission and standard of excellence is central to every activity of the Gallery, from caring for and strengthening the collection to presenting special exhibitions and organizing public programs.

A substantial portion of the Gallery's operations is funded from annual federal appropriations. Since its founding, federal funds ensure the operation and maintenance and the protection and care of the nation's art collection enabling the Gallery to remain open 363 days a year at no charge to visitors. The Gallery also receives federal appropriations for the repair and restoration of its facilities.

In addition to federal appropriations, the Gallery receives private donations and earns income from investments. Private donations from individuals, foundations and corporations have provided support for art acquisitions and conservation, scholarly and scientific research, exhibitions, and education outreach programs.

## (2) Summary of Significant Accounting Policies

### (a) General

The Gallery receives annual federal appropriations to cover its core programs and renovation of its buildings as part of the budget approved annually by Congress and signed by the President. This is supplemented with income from endowments designated for current operating expenditures as well as gifts and grants designated by donors for other specific expenditures. All monies, related activities and balances from federal sources are referred to herein as "federal," while all other monies, related activities and balances are referred to herein as "private."

### (b) Measure of Operations

The Gallery includes in its measure of operations all federal and private support and revenue and expenses that are integral to its core program services: collections; special exhibitions; education, Gallery shops and public programs; and editorial and photography. The measure of operations excludes certain nonoperating activities such as non-operating gifts and grants (endowment gifts, gifts for art acquisitions, and capital projects), investment return less amounts designated for operations, acquisitions of works of art and depreciation expense.

The Gallery's Board of Trustees appropriates only a portion of the Gallery's cumulative investment return for support of current operations and art acquisitions; the remainder is retained to support operations of future years and to offset potential market declines. The amount appropriated is computed under the Gallery's spending policy and is appropriated for use based on the underlying donor-imposed restrictions (see Note 5).

# NATIONAL GALLERY OF ART

## Notes to Financial Statements

September 30, 2012

(In thousands)

### (c) *Summarized Financial Information*

The financial statements include certain summarized prior-year information in total only. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Gallery's financial statements for the year ended September 30, 2011, from which the summarized information was derived.

### (d) *Net Assets*

The Gallery's net assets, support and revenue, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Gallery are classified and reported as follows:

- *Unrestricted* net assets include "one-year" federal appropriations and all other resources, which are not subject to donor-imposed stipulations. The unrestricted net assets of federal funds consist primarily of the Gallery's net investment building improvements and other equipment purchased or constructed using federal funds less unfunded liabilities. At the discretion of the Gallery's Board of Trustees, private funds which are not expended for operating activities may be set aside in designated reserves and earmarked to cover future program costs or other contingencies.
- *Temporarily restricted* net assets carry specific donor-imposed stipulations on the expenditure or other use of the contributed funds. In addition, the Gallery's "no-year" federal appropriations for special exhibitions and for the repair, renovation and restoration of its buildings are classified as temporarily restricted net assets.

Temporary restrictions may expire by the passage of time or as a result of fulfillment of the donor's stipulations. For gifts restricted for capital additions, net assets are released when capital expenditures are incurred.

- *Permanently restricted* net assets have donor-imposed stipulations that require that the corpus of the gifts be retained permanently. In some cases, the donor has also permanently restricted the use of excess income and any realized or unrealized gains attributable to the corpus.

### (e) *Cash and Cash Equivalents*

Cash and cash equivalents include interest-bearing demand deposits and appropriated amounts yet to be disbursed remaining on deposit with the U.S. Department of Treasury (or U.S. Treasury). The Gallery considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents, except where such cash equivalents are held as part of a long-term investment strategy (see Note 5).

The fund balances with U.S. Treasury consists of appropriated funds that are available to pay current liabilities and finance authorized purchase commitments of the Gallery. The Gallery's fund balances with U.S. Treasury are carried forward until such time as goods or services are received and payments are made, or until the funds are returned to the U.S. Treasury.

# NATIONAL GALLERY OF ART

## Notes to Financial Statements

September 30, 2012

(In thousands)

**(f) *Pledges Receivable***

Unconditional promises to contribute to the Gallery in the future (pledges receivable) are recorded at the fair value of future cash flows, after providing an allowance for uncollectibility. For unconditional promises to give recognized prior to October 1, 2008, a risk-free rate of return at the date of the gift was used. For unconditional promises to give recognized on or after October 1, 2008, a discount rate approximating the current market rate at the date of the gift is used. Conditional promises to give are recognized as income when the conditions stipulated by the donor are substantially met.

**(g) *Investments and Trusts Held by Others***

Investments are generally reported at fair value. Common and preferred stocks and mutual funds are valued using readily determinable market prices. Alternative investments are reported at the estimated fair value as provided by the investment managers. The Gallery reviews and evaluates valuation methods and assumptions the investment managers use in determining the fair value. For investments valued based on manager reported net asset values, the Gallery applies procedures to assess the valuation including comparing performance to relevant market indices and verifying the underlying asset values to quoted market prices. Due to the uncertainty of valuation of these alternative investments, their values may differ from values that would have been used had a ready market for the investments existed.

Purchases and sales of securities are reflected on a trade-date basis. Gains and losses on sales of securities are based on average historical value (cost of securities if purchased or the fair market value at the date of gift if received by donation). Dividend and interest income is recorded when earned on an accrual basis. In accordance with the policy of stating investments at fair value, the net change in unrealized appreciation or depreciation for the year is reflected in the statement of activities (see Note 5).

The Gallery has been named as beneficiary in several irrevocable charitable trusts held by third parties. The Gallery's share of these trusts is generally recorded at current fair value. Income distributions from these trusts are recorded as investment income and changes in the value of these trusts are recorded as "changes in the value of trusts held by others" in the statement of activities.

**(h) *Accounts Receivables and Other Assets***

Accounts receivable and other assets includes accounts receivable, deferred private expenses incurred in connection with future special exhibitions, Gallery shops inventory, and real property held for sale that is recorded at the estimated net realizable value.

**(i) *Property, Plant and Equipment***

The land occupied by the Gallery's buildings was appropriated and reserved by the Congress of the United States for that purpose. No value has been assigned in the accompanying financial statements.

# NATIONAL GALLERY OF ART

## Notes to Financial Statements

September 30, 2012

(In thousands)

Property, plant and equipment with a cost of \$50 or more is capitalized at cost and depreciated using the straight-line method over the useful life of the assets. These assets have been assigned a useful life as follows:

Buildings	50 years
Building improvements	up to 25 years
Equipment under capital lease	14 years
Equipment	5 – 10 years
Computer software	3 – 5 years

Other property items are expensed when purchased. Normal repairs and maintenance are charged to expense as incurred.

**(j) Art Collections**

The Gallery's art collections focus upon European and American paintings, sculpture and works on paper. In conformity with accounting policies generally followed by art museums, the value of art has been excluded from the statement of financial position.

The Gallery's collections are maintained for public exhibition, education and research in furtherance of public service, rather than for financial gain.

The Gallery acquires its art collections through purchase or by donations-in-kind. Only current year purchases made from specifically designated funds, not donations-in-kind, are reflected in the statement of activities. The Gallery does not deaccession any of its permanent collections.

**(k) Accrued Leave**

Annual leave is accrued as it is earned by employees and is included in personnel compensation and benefit costs. An unfunded liability as of the date of the financial statements is recognized for earned but unused annual leave by federal employees since this annual leave will be paid from future federal appropriations when the leave is used by employees. The amount accrued is based upon current pay of the employees.

**(l) Unexpended Federal One-Year Appropriations**

The Gallery's federal one-year appropriations are recognized as revenue as expenditures are incurred throughout the year. One-year federal appropriations which are not obligated or expended are retained by the Gallery in accordance with federal guidelines and returned to the U.S. Department of Treasury after five years. The remaining unexpended balances of these funds are classified as a liability on the statement of financial position.

**(m) Employee Benefits**

The pension expense recognized in the Gallery's financial statements is equal to the current service cost for the Gallery's employees for the accounting period less the amount contributed by the employees. The measurement of the pension service cost requires the use of an actuarial cost method and assumptions with factors applied by the Gallery. These factors are supplied by the Office of

# NATIONAL GALLERY OF ART

## Notes to Financial Statements

September 30, 2012

(In thousands)

Personnel Management (OPM), the agency that administers the plan. The excess of the recognized pension expense over the amount contributed by the Gallery represents the amount being financed directly through the Civil Service Retirement and Disability Fund administered by OPM; therefore the excess financing costs are not recognized in the Statement of Activities. This amount is considered imputed financing by the Gallery.

All permanent employees of the Gallery, both federal and nonfederal, hired subsequent to January 1, 1984 participate in both the Social Security Retirement System and the Federal Employees' Retirement System (FERS). Employees hired prior to January 1, 1984 had the option of remaining under the Civil Service Retirement System (CSRS) or electing FERS. All employees have the option to make tax-deferred contributions to a Thrift Savings Plan and, in some instances, receive a matching portion from the Gallery. The Gallery funds all retirement contributions on a current basis, and accordingly there are no unfunded retirement costs (see Note 14).

The Gallery recognizes a current period expense for the future cost of post-retirement health benefits and life insurance for its employees while they are still working. The Gallery accounts for this expense in its financial statements in a manner similar to that used for pension expense, with the exception that employees and the Gallery do not make current contributions to fund these future benefits.

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from the Gallery for these paid claims.

The actuarial FECA liability represents the liability for expected future workers' compensation benefits, which includes the liability for death, disability, medical, and miscellaneous costs for approved cases. The actuarial liability is determined by DOL annually, as of September 30, using a method that utilizes historical benefits payment patterns related to a specific incurred period, wage inflation factors, medical inflation factors and other variables. These actuarially computed projected annual benefit payments are discounted to present value using OMB's economic assumptions for ten-year U.S. Treasury notes and bonds. The Gallery computes its actuarial FECA liability based on the model provided by DOL and presents it as a liability to the public on the statement of financial position because neither the costs nor reimbursements have been recognized by DOL. The change in the projected FECA liability is reported in the Statement of Activities. The FECA actuarial liability is recorded for financial reporting purposes only. This liability constitutes an extended future estimate of cost which will not be obligated against budgetary resources until the fiscal year in which DOL actually bills the cost to the Gallery. The cost associated with this liability cannot be met by the Gallery without further appropriation action.

**(n) *Imputed Financing Sources***

In certain cases, costs of the Gallery are paid out of funds appropriated to other federal agencies. As an example, the law requires certain costs of retirement programs to be paid by OPM and certain legal judgments against the Gallery to be paid from the Judgment Fund maintained by U.S. Treasury.

# NATIONAL GALLERY OF ART

## Notes to Financial Statements

September 30, 2012

(In thousands)

Costs that are identifiable to the Gallery and directly attributable to the Gallery's operations are paid by these federal agencies however, imputed costs and offsetting federal funding amounts are not recognized in the Statement of Activities.

Imputed costs and offsetting federal funding amounts for pension, health and life insurance benefits are computed and presented in footnote 14.

**(o) *Contributed Services and Donated Assets***

The Gallery has volunteers who provide assistance in various departments. Such contributed services do not meet the criteria for recognition of contributed services and accordingly, are not reflected in the accompanying financial statements.

Donated assets, which do not become part of the Gallery's art collections, are recorded at their fair value at the date of the gift. The Gallery does not imply time restrictions for gifts of long-lived assets. As a result, in the absence of donor-imposed restrictions, gifts of long-lived assets are reported as unrestricted revenue.

**(p) *Functional Allocation of Expenses***

The cost of providing various programs and other activities summarized on a functional basis is shown in Note 12. Certain costs including depreciation, utilities, building maintenance, security, information systems and other operating costs have been allocated among program and supporting services.

Included under the Collections category are the costs of the care and display of the Gallery's collections. Special exhibition expenses include travel, transportation of items, and other services necessary for the display of special exhibitions. Education, Gallery shops and public programs includes the cost of providing a wide array of lectures, tours, films, music, symposia and academic programs to the general public, in addition to Gallery shops cost of goods sold and expenses. Editorial and photography expenses include the costs to produce the many publications produced by the Gallery. General and administrative expenses include costs for executive management, financial administration, human resources and legal services. Development expenses include those costs associated with individual and corporate gifts and grants, annual appeals and other fundraising efforts.

**(q) *Estimates***

The preparation of the financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingencies at the date of the financial statements, and the reported amounts of support and revenue and expenses during the reporting period. Actual results could differ from these estimates.

# NATIONAL GALLERY OF ART

## Notes to Financial Statements

September 30, 2012

(In thousands)

(r) ***Risks and Uncertainties***

The Gallery invests in a variety of investment securities. Investment securities are exposed to risks such as interest rate, market, and credit risks. As a result, changes in the values of investment securities may occur that could materially affect the value of the Gallery's investments and its financial position.

(s) ***Reclassifications***

Certain prior year balances have been reclassified to conform to current year presentation. The following changes to the Statement of Activities were made to enhance the presentation of the results:

- Appropriation revenue recognized for property, plant and equipment acquisitions was reclassified from operating to non-operating.
- The Gallery refined the model and methodology for allocating certain general and administrative costs to program activities.

(3) **Fund Balance with U.S. Treasury**

As of September 30, 2012 and 2011, fund balance with U.S. Treasury consisted of the following:

	<u>2012</u>	<u>2011</u>
Appropriated funds	\$ <u>65,254</u>	\$ <u>98,114</u>
Status of fund balance with U.S. Treasury		
Unobligated balance:		
Available	9,351	13,724
Unavailable	1,013	956
Obligated balance not yet disbursed	<u>54,890</u>	<u>83,434</u>
Total	\$ <u>65,254</u>	\$ <u>98,114</u>

**NATIONAL GALLERY OF ART**

Notes to Financial Statements

September 30, 2012

(In thousands)

**(4) Pledges Receivable, Net**

As of September 30, 2012 and 2011, pledges receivable, net, consisted of the following:

	<b>2012</b>	<b>2011</b>
Due in one year or less	\$ 3,901	\$ 5,274
Due between one year and five years	15,793	1,975
Due in more than five years	—	100
Subtotal	19,694	7,349
Less discounts of \$670 and \$208 and allowances of \$150 and \$150 respectively	(820)	(358)
Total	\$ 18,874	\$ 6,991

As of September 30, 2012 and 2011, \$14,273 and \$373 of the pledge receivable balance was receivable from related parties.

**(5) Investments, Trusts Held by Others and Fair Value Measurement**

As of September 30, 2012 and 2011, investments and trust held by others consisted of the following:

	<b>2012</b>	<b>2011</b>
Investments	\$ 683,039	\$ 605,462
Trusts held by others	12,540	10,535
Subtotal	695,579	615,997
Loan to U.S. Treasury	5,000	5,000
Total	\$ 700,579	\$ 620,997

In 1942, the Gallery, under authority of an Act of Congress, made a \$5,000 permanent loan to the U.S. Treasury. This loan bears interest at the higher of 4.00% or 0.25% below the average monthly rate for long-term funds paid by the U.S. Treasury (4.00% during fiscal year 2012). Interest income on this loan was \$203 and \$203 for the fiscal years ended September 30, 2012 and 2011, respectively.

As of September 30, 2012 and 2011, the carrying value of the Gallery's cash, cash equivalents and balances with U.S. Treasury, receivables, deferred charges and other assets, loan to the U.S. Treasury, and accounts payable and accrued expenses approximate their fair values because of the terms and relatively short maturity of these assets and liabilities. The Gallery's investments in private equity, venture capital, and real estate are generally valued based on the most current net asset value (NAV) adjusted for cash flows when the reported NAV is not at the measurement date.

# NATIONAL GALLERY OF ART

## Notes to Financial Statements

September 30, 2012

(In thousands)

The fair value of a financial instrument is the exit price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The Gallery applies a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair. The hierarchy consists of three broad levels:

- *Level 1* – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Gallery has the ability to access as of the reporting date. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment. Investments include investments in equity securities custodied in separate accounts and equity, real estate, and fixed income mutual funds that are traded in an active exchange market.
- *Level 2* – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly as of the reporting date. Investments consist of limited partnerships and limited liability companies where the underlying investments are, for the most part, marketable securities. The Gallery receives monthly statements from the investment managers but has no direct visibility of the underlying securities.
- *Level 3* – Valuations based on inputs that are unobservable and significant to the overall fair value measurement as of the reporting date. The determination of fair value for these financial instruments requires one or more inputs subject to significant management judgment or estimation. Investments consist of limited partnership and limited liability companies where the underlying investments include private equity, venture capital, hedge funds, and private real estate for which there is no active market and for which the inputs into the fair value estimate are unobservable. The portfolio holdings of underlying funds in Level 3 investments may not be disclosed; therefore the Gallery relies on the investment manager to provide a valuation estimate which is generally based on the most current net asset value (NAV) adjusted for cash flows when the reported NAV is not at the measurement date. Trusts held by others are also valued using Level 3 inputs. One trust is invested in real property and has been recorded at the value of the real property as of the date of the gift based on property valuations that involved significant judgments and estimation. One trust is a perpetual trust invested in equity, fixed income securities, and mutual funds where the Gallery receives annual distributions but will never received the trust's principal. The remainder of the trusts are invested in cash equivalents, mutual funds, and publicly traded equities.

**NATIONAL GALLERY OF ART**

Notes to Financial Statements

September 30, 2012

(In thousands)

The following tables summarize the fair value of investments and trusts held by others as of September 30, 2012 and 2011 for financial assets by pricing observability levels:

	<b>Prices in active markets for identical assets (Level 1)</b>	<b>Other observable inputs (Level 2)</b>	<b>Unobservable inputs (Level 3)</b>	<b>Fair value at September 30, 2012</b>
U.S. equities	\$ 93,856	\$ 62,489	\$ —	\$ 156,345
International equities				
Developed market equities	46,875	54,126	—	101,001
Emerging market equities	—	42,488	—	42,488
Real estate	15,571	—	4,926	20,497
Inflation hedging securities	—	36,684	—	36,684
Private equity and venture capital funds	—	—	52,850	52,850
Hedge fund of funds	—	—	144,914	144,914
Multi-asset fund	—	—	44,411	44,411
Fixed income securities	78,158	—	—	78,158
Charitable gift annuities and other	5,691	—	—	5,691
Trusts held by others	—	—	9,994	9,994
Assets measured at fair value on a recurring basis	<u>240,151</u>	<u>195,787</u>	<u>257,095</u>	<u>693,033</u>
Trust held by others	<u>—</u>	<u>—</u>	<u>2,546</u>	<u>2,546</u>
Assets measured at fair value on a non-recurring basis	<u>—</u>	<u>—</u>	<u>2,546</u>	<u>2,546</u>
Total	<u>\$ 240,151</u>	<u>\$ 195,787</u>	<u>\$ 259,641</u>	<u>\$ 695,579</u>

**NATIONAL GALLERY OF ART**

Notes to Financial Statements

September 30, 2012

(In thousands)

	<b>Prices in active markets for identical assets (Level 1)</b>	<b>Other observable inputs (Level 2)</b>	<b>Unobservable inputs (Level 3)</b>	<b>Fair value at September 30, 2011</b>
U.S. equities	\$ 71,813	\$ 50,345	\$ —	\$ 122,158
International equities				
Developed market equities	26,108	60,855	—	86,963
Emerging market equities	—	34,526	—	34,526
Real estate	12,081	—	3,957	16,038
Inflation hedging securities	—	33,112	—	33,112
Private equity and venture capital funds	—	—	53,123	53,123
Hedge fund of funds	—	—	137,741	137,741
Multi-asset fund	—	—	43,940	43,940
Fixed income securities	72,826	—	—	72,826
Charitable gift annuities and other	5,035	—	—	5,035
Trusts held by others	—	—	7,989	7,989
	<hr/>	<hr/>	<hr/>	<hr/>
Assets measured at fair value on a recurring basis	187,863	178,838	246,750	613,451
Trust held by others	—	—	2,546	2,546
	<hr/>	<hr/>	<hr/>	<hr/>
Assets measured at fair value on a non-recurring basis	—	—	2,546	2,546
Total	<u>\$ 187,863</u>	<u>\$ 178,838</u>	<u>\$ 249,296</u>	<u>\$ 615,997</u>

## NATIONAL GALLERY OF ART

### Notes to Financial Statements

September 30, 2012

(In thousands)

The following table summarizes the changes in Level 3 assets, measured at fair value on a recurring basis, as of September 30, 2012:

	<u>Real estate</u>	<u>Private equity and venture capital funds</u>	<u>Hedge fund of funds</u>	<u>Multi-asset fund</u>	<u>Trusts held by others</u>
Fair value of Level 3 assets at September 30, 2011	\$ 3,957	\$ 53,123	\$ 137,741	\$ 43,940	\$ 7,989
(Expenses) net of dividends and interest	(65)	(1,021)	(600)	(143)	—
Realized and unrealized gains	444	3,314	13,373	2,833	1,586
Proceeds from sales, redemptions and distributions	(278)	(8,801)	(8,379)	(2,219)	(484)
Purchase of investments	868	6,235	2,779	—	903
Fair value of Level 3 assets at September 30, 2012	<u>\$ 4,926</u>	<u>\$ 52,850</u>	<u>\$ 144,914</u>	<u>\$ 44,411</u>	<u>\$ 9,994</u>

The following table summarizes the changes in Level 3 assets, measured at fair value on a recurring basis, as of September 30, 2011:

	<u>Real estate</u>	<u>Private equity and venture capital funds</u>	<u>Hedge fund of funds</u>	<u>Multi-asset fund</u>	<u>Trusts held by others</u>
Fair value of Level 3 assets at September 30, 2010	\$ 2,192	\$ 37,769	\$ 112,690	\$ 42,587	\$ 10,119
(Expenses) net of dividends and interest	(18)	(698)	(627)	(57)	—
Realized and unrealized gains (losses)	390	12,060	(1,181)	3,677	(390)
Proceeds from sales, redemptions and distributions	(125)	(5,776)	(34,141)	(2,267)	(1,758)
Purchase of investments	1,518	9,768	61,000	—	18
Fair value of Level 3 assets at September 30, 2011	<u>\$ 3,957</u>	<u>\$ 53,123</u>	<u>\$ 137,741</u>	<u>\$ 43,940</u>	<u>\$ 7,989</u>

## NATIONAL GALLERY OF ART

### Notes to Financial Statements

September 30, 2012

(In thousands)

The fair values of the following investments have been estimated using the net asset value per share of the investments as of September 30, 2012:

		<u>Fair value</u>	<u>Commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
U.S. equities	(a)	62,489	—	Quarterly	60 days
International equities	(b)				
Developed market equities		54,126	—	Daily to Semi-Monthly	6 to 20 days
Emerging market equities		42,488	—	Monthly	30 to 120 days
Real estate	(c)	4,926	1,144	N/A	N/A
Inflation hedging securities	(d)	36,684	—	Monthly	30 days
Private equity and venture capital funds	(e)	52,850	26,161	N/A	N/A
Hedge fund of funds	(f)	144,914	—	Semi-Annually to 2 years	90 to 95 days
Multi-asset fund	(g)	44,411	—	Annually	365 days
Total		<u>\$ 442,888</u>	<u>\$ 27,305</u>		

The fair values of the following investments have been estimated using the net asset value per share of the investments as of September 30, 2011:

		<u>Fair value</u>	<u>Commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
U.S. equities	(a)	50,345	—	Quarterly	60 days
International equities	(b)				
Developed market equities		60,855	—	Daily to Monthly	6 to 20 days
Emerging market equities		34,526	—	Monthly	30 to 120 days
Real estate	(c)	3,957	2,013	N/A	N/A
Inflation hedging securities	(d)	33,112	—	Monthly	30 days
Private equity and venture capital funds	(e)	53,123	25,396	N/A	N/A
Hedge fund of funds	(f)	137,741	—	1 to 3 years	90 to 95 days
Multi-asset fund	(g)	43,940	—	Annually	365 days
Total		<u>\$ 417,599</u>	<u>\$ 27,409</u>		

## NATIONAL GALLERY OF ART

### Notes to Financial Statements

September 30, 2012

(In thousands)

- (a) U.S. equities: Investments in equity securities of large cap and small cap U.S. companies comprised of a fund that invests in U.S. equities.
- (b) International equities: Investments in equity securities of international companies in both developed and emerging markets comprised of investments in mutual funds, limited partnerships and limited liability companies.
- (c) Real estate: Investments in privately held real estate comprised of investments in private limited partnerships.
- (d) Inflation hedging securities: Investments in securities which are expected to perform well in periods of high inflation, including precious metals, energy, commodities, natural resources, and U.S. Treasury Inflation Protected Securities (TIPS) comprised of an investment in a limited partnership.
- (e) Private equity and venture capital funds: Investments in limited partnerships which invest in shares of operating companies that are not listed on a publicly traded stock exchange, including leveraged buyouts, growth capital, distressed investments, and start-ups. The limited partnerships are organized as funds of funds.
- (f) Hedge fund of funds: Investments in limited partnerships which invest in shares of hedge funds which employ strategies such as long/short equity, credit and distressed assets, and multi-strategy.
- (g) Multi-asset fund: Investment in a limited partnership which invests in shares of funds engaged in all asset classes, including U.S. and international equities, fixed income, private equity, venture capital, hedge funds, real estate, and natural resources.

The following schedule summarizes the investment return and its classification in the statement of activities for the years ended September 30, 2012 and 2011:

	2012			Total	2011 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
Dividends and interest (net of expenses of \$4,067 and \$3,607 respectively)	\$ 2,540	\$ 2,644	\$ —	\$ 5,184	\$ 4,105
Net investment appreciation	50,034	41,870	—	91,904	4
	52,574	44,514	—	97,088	4,109
Appropriated for operations	(2,750)	(13,675)	—	(16,425)	(14,368)
Appropriated for art acquisitions	(712)	(3,034)	—	(3,746)	(2,694)
Investment return less amounts appropriated for operations and art acquisitions	\$ 49,112	\$ 27,805	\$ —	\$ 76,917	\$ (12,953)

**NATIONAL GALLERY OF ART**

Notes to Financial Statements

September 30, 2012

(In thousands)

**(6) Property, Plant and Equipment, Net**

As of September 30, 2012 and 2011, net property, plant and equipment consisted of the following:

	<b>2012</b>			<b>2011 Total</b>
	<b>Private funds</b>	<b>Federal funds</b>	<b>Total</b>	
Buildings and improvements	\$ 156,310	\$ 173,110	\$ 329,420	\$ 301,803
Equipment and computer software	4,616	63,651	68,267	61,456
Construction-in-progress	1,760	66,070	67,830	48,821
Equipment under capital lease	—	2,962	2,962	2,962
Subtotal	162,686	305,793	468,479	415,042
Less accumulated depreciation and amortization	(107,513)	(94,421)	(201,934)	(190,464)
Total	\$ 55,173	\$ 211,372	\$ 266,545	\$ 224,578

**(7) Accounts Payable and Other Liabilities**

As of September 30, 2012 and 2011, accounts payable and other liabilities consisted of the following:

	<b>2012</b>			<b>2011 Total</b>
	<b>Private funds</b>	<b>Federal funds</b>	<b>Total</b>	
Accounts payable and accrued expenses	\$ 893	\$ 8,930	\$ 9,823	\$ 10,050
Employee benefits	6,267	17,794	24,061	23,450
Other accrued liabilities	3,201	5,666	8,867	6,871
Total	\$ 10,361	\$ 32,390	\$ 42,751	\$ 40,371

**(8) Contractual Obligations**

The Gallery in 2007 entered into a number of contractual obligations with various parties for the acquisition of art for its collection. These contractual obligations are unsecured, noninterest bearing and require annual payments. Final payment of these obligations was made during the year ending September 30, 2012.

**NATIONAL GALLERY OF ART**

Notes to Financial Statements

September 30, 2012

(In thousands)

As of September 30, 2012 and 2011, contractual obligations consisted of the following:

	<b>2012</b>	<b>2011</b>
Contractual obligations	\$ —	\$ 7,950
Less discounts on contractual obligations	—	(76)
Total	\$ —	\$ 7,874

The annual discount amortization recognized on these contractual obligations has been recognized as acquisitions of works of art.

**(9) Environmental Liability**

In 2006 the Gallery, in conjunction with third party consultants, determined the cost of removing asbestos and other hazardous materials from the Gallery's buildings pursuant to the Clean Air Act as amended. The cost of the remediation is amortized over the useful life of the asset.

As of September 30, 2012 and 2011 the net remediation costs included in the Gallery's property, plant and equipment consists of the following:

	<b>2012</b>	<b>2011</b>
Remediation costs	\$ 4,201	\$ 4,201
Less accumulated depreciation	(3,192)	(3,109)
Net remediation costs	\$ 1,009	\$ 1,092

The Gallery's financial statements reflect an unfunded liability for environmental remediation clean-up costs as follows:

	<b>2012</b>	<b>2011</b>
Beginning balance	\$ 19,989	\$ 19,612
Liability recorded for the period	1,066	612
Remediation costs incurred	(30)	(235)
Total	\$ 21,025	\$ 19,989

The actual cost may vary from the current estimated cost at completion in the future due to inflation and the timing of implementing the various remedies. Management annually updates the total estimated costs for completion.

**NATIONAL GALLERY OF ART**

Notes to Financial Statements

September 30, 2012

(In thousands)

**(10) Federal Appropriations**

The Gallery is funded primarily by two Congressional appropriations: one appropriation covers the Gallery's salaries, benefits and expenses, a portion of which is designated for special exhibitions, and the second appropriation provides the crucial funds necessary for the repair, restoration and renovation of the Gallery's buildings. The appropriation received for salaries, benefits and expenses is a one-year appropriation that must be obligated by the end of the fiscal year, with the exception of that portion of the appropriation designated for special exhibitions expenses, which is available until it is expended. The appropriation for the repair, restoration, and renovation of the Gallery's buildings is available until expended. The fiscal year 2012 salaries and expenses appropriation includes \$3,475 for no-year special exhibitions funding.

The Gallery's federal appropriations received in the fiscal years ending 2012 and 2011 are reconciled to federal appropriation revenue recognized as follows:

	<u>2012</u>			
	<u>Salaries and Expenses</u>	<u>Repairs, Restoration and Renovation</u>	<u>Total</u>	<u>2011</u>
Federal appropriations received	\$ 113,883	\$ 14,493	\$ 128,376	\$ 158,649
Unexpended appropriations	(8,594)	—	(8,594)	(8,320)
Amounts expended from prior years' appropriations	8,638	—	8,638	7,982
	<u>113,927</u>	<u>14,493</u>	<u>128,420</u>	<u>158,311</u>
Federal appropriation revenue recognized	<u>\$ 113,927</u>	<u>\$ 14,493</u>	<u>\$ 128,420</u>	<u>\$ 158,311</u>
Operating	\$ 106,847	\$ 3,699	\$ 110,546	\$ 108,050
Non-operating	7,080	10,794	17,874	50,261
	<u>106,847</u>	<u>10,794</u>	<u>110,546</u>	<u>108,050</u>
Total federal appropriation revenue recognized	<u>\$ 113,927</u>	<u>\$ 14,493</u>	<u>\$ 128,420</u>	<u>\$ 158,311</u>

**NATIONAL GALLERY OF ART**

Notes to Financial Statements

September 30, 2012

(In thousands)

**(11) Net Assets Released from Restrictions**

Net assets are released from donor restrictions when the expenses are incurred to satisfy the restricted purposes as specified by donors. The donor-specified restrictions that were met in the reporting period are as follows:

	<b>2012</b>			<b>2011</b>
	<b>Private</b>	<b>Federal</b>	<b>Total</b>	<b>Total</b>
Collections	\$ 2,379	\$ —	\$ 2,379	\$ 2,206
Special exhibitions	4,318	3,479	7,797	7,248
Education and public programs	4,485	—	4,485	4,548
Editorial and photography	1,498	—	1,498	203
Operations	6,127	3,660	9,787	9,339
Subtotal operating	<u>18,807</u>	<u>7,139</u>	<u>25,946</u>	<u>23,544</u>
Acquisition of art	7,607	—	7,607	8,131
Capital projects	733	45,964	46,697	32,233
Subtotal non-operating	<u>8,340</u>	<u>45,964</u>	<u>54,304</u>	<u>40,364</u>
Total	<u>\$ 27,147</u>	<u>\$ 53,103</u>	<u>\$ 80,250</u>	<u>\$ 63,908</u>

## NATIONAL GALLERY OF ART

### Notes to Financial Statements

September 30, 2012

(In thousands)

#### (12) Functional Classification of Expenses

Expenses by functional classification for fiscal years 2012 and 2011 are shown below:

	<b>2012</b>			<b>2011</b>
	<b>Private</b>	<b>Federal</b>	<b>Total</b>	<b>Total</b>
Total operating expenses from the statement of activities	\$ 34,616	\$ 110,679	\$ 145,295	\$ 141,559
Expenses included in the nonoperating section of the statement of activities:				
Depreciation and amortization	3,290	8,180	11,470	11,152
Environmental liability	—	1,066	1,066	612
Total expenses	<u>\$ 37,906</u>	<u>\$ 119,925</u>	<u>\$ 157,831</u>	<u>\$ 153,323</u>
Program services:				
Collections	\$ 4,958	\$ 46,389	\$ 51,347	\$ 50,252
Special exhibitions	6,200	14,530	20,730	18,761
Education, Gallery shops and public programs	15,861	24,872	40,733	40,189
Editorial and photography	2,190	4,461	6,651	6,569
Subtotal program expenses	<u>29,209</u>	<u>90,252</u>	<u>119,461</u>	<u>115,771</u>
Supporting services:				
General and administrative	5,934	27,826	33,760	32,932
Development	2,763	1,847	4,610	4,620
Subtotal supporting services	<u>8,697</u>	<u>29,673</u>	<u>38,370</u>	<u>37,552</u>
Total expenses	<u>\$ 37,906</u>	<u>\$ 119,925</u>	<u>\$ 157,831</u>	<u>\$ 153,323</u>

#### (13) Endowments and Net Asset Classifications

The Gallery's endowment consists of seventy-one individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Gallery's Board of Trustees has resolved to be guided by the standards in the Uniform Prudent Management of Institutional Funds Act (UPMIFA), as enacted by the District of Columbia on January 23, 2008, in the management, investment, and expenditure of Gallery endowment funds although it is not required to do so as a matter of law. The Board has interpreted the UPMIFA as allowing the Gallery to appropriate for expenditure or accumulate so much of an endowment fund as the Gallery determines is prudent for the uses, purposes and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument. Unless stated otherwise in the gift instrument, the assets in an endowment fund shall be donor-restricted assets until appropriated for expenditure by the Gallery. As a result of this interpretation, the Gallery has not changed the way permanently restricted net assets are classified. The Gallery continues to classify as permanently restricted net assets (a) the original

## NATIONAL GALLERY OF ART

### Notes to Financial Statements

September 30, 2012

(In thousands)

value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Gallery in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Gallery considers the following factors when making a determination to appropriate or accumulate donor-restricted funds:

- The duration and preservation of the fund
- The purposes of the Gallery and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Gallery
- The investment policies of the Gallery

Endowment net assets were comprised of the following as of September 30, 2012 and 2011:

	2012		2011	
	Donor- restricted endowment funds	Board- designated endowment funds	Donor- restricted endowment funds	Board- designated endowment funds
Unrestricted	\$ (12,052)	\$ 23,026	\$ (31,497)	\$ 18,537
Temporarily restricted	60,121	—	37,657	—
Permanently restricted	369,835	—	364,337	—
Total funds	\$ 417,904	\$ 23,026	\$ 370,497	\$ 18,537

## NATIONAL GALLERY OF ART

### Notes to Financial Statements

September 30, 2012

(In thousands)

The following table summarizes the change in the endowment funds during the years ended September 30, 2012 and 2011:

	<u>2012</u>			<u>2011</u> <u>Total</u>	
	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>		<u>Total</u>
Endowment net assets as of October 1,	\$ (12,960)	\$ 37,657	\$ 364,337	\$ 389,034	\$ 397,300
Investment return:					
Investment income	86	2,301	—	2,387	3,622
Net appreciation (depreciation)	22,168	33,651	1,158	56,977	(354)
Total investment return	22,254	35,952	1,158	59,364	3,268
Contributions	2,176	—	4,340	6,516	974
Appropriation of endowment assets for expenditures	(688)	(13,501)	—	(14,189)	(14,193)
Reclassifications	192	13	—	205	1,685
Endowment net assets as of September 30,	<u>\$ 10,974</u>	<u>\$ 60,121</u>	<u>\$ 369,835</u>	<u>\$ 440,930</u>	<u>\$ 389,034</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the Gallery to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were \$12,052 and \$31,497 as of September 30, 2012 and 2011, respectively. These deficiencies were the result of unfavorable market fluctuations that occurred after the investment of new contributions and continued appropriation for certain programs that was deemed prudent by the Gallery. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

The Gallery has adopted investment and spending policies for endowment assets that are intended to provide a predictable stream of funding for programs while maintaining the purchasing power of the endowment. Under the investment policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that reduces risk through diversification while obtaining a competitive rate of return. To satisfy its long-term rate-of-return, the Gallery relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yields (interest and dividends). The Gallery targets diversified asset allocation that utilizes fixed income and equity-based investments to achieve its long-term objectives within prudent risk constraints.

The Gallery's spending policy is based on an annual endowment spending rate of 5.00% of the average fair value of endowment investments at the end of the previous three-and-one quarter years. This spending rate constitutes the Board's annual appropriation for spending endowment earnings to support both the purchase of art and support of operations.

## NATIONAL GALLERY OF ART

### Notes to Financial Statements

September 30, 2012

(In thousands)

The following table summarizes the purpose of the net asset restrictions during the years ended September 30, 2012 and 2011:

	<b>2012</b>			<b>2011</b> <b>Total</b>
	<b>Temporarily restricted</b>	<b>Permanently restricted</b>	<b>Total</b>	
Acquisition of art	\$ 31,889	\$ 75,478	\$ 107,367	\$ 98,703
Collections	8,066	36,038	44,104	40,614
Special exhibitions	17,896	31,646	49,542	43,016
Education and public programs	39,943	82,624	122,567	116,031
Editorial and photography	900	3,498	4,398	4,037
Capital projects	19,100	—	19,100	—
Federal repair and renovation projects	34,645	—	34,645	69,776
Operations	40,029	140,551	180,580	175,101
Total	<u>\$ 192,468</u>	<u>\$ 369,835</u>	<u>\$ 562,303</u>	<u>\$ 547,278</u>

#### (14) Employee Benefits

Total pension expense recognized in the Gallery's financial statements was \$7,571 and \$7,319 for the years ended September 30, 2012 and 2011, respectively. These amounts do not include pension expense financed by OPM and imputed to the Gallery of \$2,372 and \$2,730 respectively. To the extent that Gallery employees are covered by the thrift savings component of FERS, the Gallery's payments to the plan are recorded as operating expenses. The Gallery's costs associated with the thrift savings component of FERS for the years ended September 30, 2012 and 2011, were \$2,374 and \$2,276, respectively.

In addition, the Gallery makes matching contributions for all employees who are eligible for current health and life insurance benefits. The Gallery's contributions for active employees are recognized as operating expenses. During fiscal years 2012 and 2011, the Gallery contributed \$5,637 and \$5,472, respectively. Using the cost factors supplied by OPM, the Gallery has not recognized as an expense in its financial statements the future cost of post-retirement health benefits and life insurance for its employees. These costs amounted to approximately \$5,581 and \$6,077 during fiscal years 2012 and 2011 respectively, and are financed by OPM and imputed to the Gallery.

The Gallery has a commitment to certain key employees whereby the Gallery will pay those employees a specified amount at a future point in time. The cost of these benefits is accrued over the key employees' future years of service to the Gallery. The cost of these benefits for fiscal years 2012 and 2011 total \$270 and \$303, respectively, and is recognized as an expense in the statement of activities and as a liability included in accounts payable and other liabilities in the accompanying statement of financial position.

# NATIONAL GALLERY OF ART

## Notes to Financial Statements

September 30, 2012

(In thousands)

### (15) Income Taxes

The Gallery is a nonprofit organization exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code.

Tax positions are recognized or derecognized based on a more-likely than-not threshold. This applies to positions taken or expected to be taken in a tax return. The Gallery does not believe its financial statements include any uncertain tax positions.

### (16) Lease Commitments

During fiscal year 2002, the Gallery entered into a capital lease obligation in connection with the installation of equipment. The Gallery has also entered into several operating leases for warehouse and office space, which continue through January 31, 2018. The terms of these operating leases include additional rent for operating expenses, real estate taxes, utilities and maintenance. Future minimum lease payments under these leases for the fiscal years ended September 30 are as follows:

	2012	
	Capital lease	Operating lease
2013	\$ 343	\$ 3,853
2014	343	1,809
2015	344	911
2016	345	933
2017	—	955
Thereafter	—	1,224
Total minimum lease payments	1,375	\$ 9,685
Less amount representing interest	(265)	
Present value of minimum capital lease payments	\$ 1,110	

Rental expense was approximately \$4,821 and \$4,787 for the years ended September 30, 2012 and 2011, respectively.

### (17) Subsequent Events

The Gallery has performed an evaluation of subsequent events through November 15, 2012, which is the date the financial statements were available to be issued, noting no events which affect the financial statements as of September 30, 2012.